

Decision **PROPOSED DECISION OF ALJ MILES** (Mailed 5/21/2015)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of the DEL ORO WATER COMPANY (U 61 W) to Review The Reasonableness Of Its General Office, Affiliate Transactions and Non-Tariffed Goods and Services, As Required by Resolution W-4954.

Application 13-12-002  
(Filed December 2, 2013)

**DECISION ADOPTING THE JOINT SETTLEMENT AGREEMENT WITH MODIFICATIONS AND MOVING ATTACHMENTS INTO THE RECORD**

**Summary**

This decision adopts the November 20, 2014 settlement agreement between Del Oro Water Company and the Office of Ratepayer Advocates,<sup>1</sup> with modifications. The settlement resolves the issues of concern arising under Affiliate Transaction Rules set out in Decision 10-10-019 and Resolution W-4954, related to reasonableness of general office costs and affiliated transactions charged to ratepayers. This decision modifies settlement agreement Sections 3.12-3.19, substituting an audit performed by the Division of Water and Audits, in lieu of an Independent Audit “supervised” by the Division of Water and Audits. The proceeding is closed.

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<sup>1</sup> The Division of Ratepayer Advocates’ was named the Office of Ratepayer Advocates effective September 26, 2013, pursuant to Senate Bill No. 96 (Budget Act of 2013; public resources), which was approved by the Governor on September 26, 2013.

## **1. Background and Procedural History**

Del Oro Water Company (DOWC or the Company) is a Class B multi-district water company providing service to 17 districts throughout California. Among the districts served are the Pine Flat District (Pine Flat) and the Pine Mountain District (Pine Mountain), which are located approximately two miles southeast of California Hot Springs in Tulare County. These two districts serve approximately 288 metered customers. On December 7, 2011, DOWC filed Advice Letter 315-A which sought to (1) consolidate the Pine Flat and Pine Mountain districts, and (2) increase water service rates in those districts in order to recover increased operating expenses and earn a reasonable rate of return on plant investment.

On October 3, 2013, the Commission issued Resolution W-4954 in response to Advice Letter 315-A. Resolution W-4954 granted DOWC an interim increase in revenues (subject to refund), and granted DOWC's request to consolidate the two districts. However, it recommended maintaining separate rate structures for each service area until DOWC's next general rate case (GRC) for Pine Flat and Pine Mountain. Resolution W-4954 also raised issues of concern regarding DOWC's affiliate transactions. Ordering Paragraph 4 of the Resolution required DOWC to file an application for review of the reasonableness of the general office, affiliate transactions and non-tariffed goods and services charged to DOWC ratepayers. Accordingly, DOWC filed Application (A.) 13-12-002 on December 1, 2013.<sup>2</sup>

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<sup>2</sup> A.13-12-002 includes nine exhibits, including its Affiliate Transaction Rules Compliance Plan, Affiliated Company Transactions Procedures, Various Exhibits to Affiliated Company Transactions Procedures and Continuing Services Agreement for DOWC affiliates.

The Office of Ratepayer Advocates (ORA) filed a protest on January 3, 2014. ORA expressed concern that DOWC had not completed the first independent audit required by Decision (D.) 10-10-019<sup>3</sup> by September 30, 2013. The Commission's Division of Water and Audits (DWA) granted DOWC a six-month extension to submit the audit under D.10-10-019. On March 17, 2014, DOWC submitted an Independent Accountant's report for the period June 30, 2011 through December 31, 2012, however, the cover letter to that report expressly declined to verify that DOWC was in compliance.<sup>4</sup> On April 24, 2014, DWA advised DOWC that the report did not comply and directed the Company to submit a revised audit report by August 1, 2014.

A Prehearing Conference was held on May 28, 2014. The parties - DOWC and ORA - informed the Administrative Law Judge (ALJ) that they anticipated filing a motion for approval of settlement on or after DOWC filed its independent audit report due August 1, 2014.

DOWC then submitted a second report in August 2014, this time with a cover letter by auditors stating that they were certifying the results. However, the body of the report was entirely the same. DWA did not accept the second report as adequate.

During a telephonic status conference on September 24, 2014, the parties indicated that unresolved financial issues prevented completion of the audit

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<sup>3</sup> D.10-10-019, Rule VIII.E requires a water utility to have an audit performed biennially by independent auditors. The audit must cover the last two calendar years ending December 31 and must verify that the utility is in compliance with the affiliate transaction rules implemented by D.10-10-019.

<sup>4</sup> The cover letter stated: "We were not engaged to and did not conduct an examination [audit], the objective of which would be the expression of an opinion on DOWC's adherence to the Affiliate Transaction Rules Compliance Plan."

report and that DOWC anticipated completion of the report on or before November 17, 2014.

On October 22, 2014, the assigned Commissioner issued a Scoping Memo and Ruling under which the following matters were deemed to be within the scope of the proceeding:

- a. Whether Del Oro's allocation of expenses among its districts are appropriate and reasonable under the affiliate transaction rules in D.10-10-019;
- b. Whether Del Oro's methodology for calculating compensation properly accounts for direct overhead costs that should be allocated to the affiliate entities such as (i) payroll benefits, (ii) shared costs such as office space, equipment and supplies, and professional service and liability insurance;
- c. Whether Del Oro's audit report complies with Affiliate Transaction Rule VIII.E in Appendix A to D.10-10-019;
- d. Whether Del Oro's revised Affiliate Transactions Compliance Plan and Procedures called for in Ordering Paragraph 5 of Res. W-4954 is consistent with, and satisfies, the requirements of Affiliate Transaction Rule VIII.C in Appendix A to D.10-10-019; and
- e. Are any safety considerations raised by this proceeding?

An evidentiary hearing was set for December 15, 2014. However, on November 20, 2014, the parties filed a joint motion for approval of settlement agreement, and the hearing was removed from calendar.

## **2. The Settlement**

### **2.1. Allocation of Expenses**

DOWC recognizes two affiliates that are subject to Affiliate Transaction Rule (AT Rule) II.E. These are its parent company, Utility Management Services (UMS),<sup>5</sup> and The Safor Corporation (SAFOR).<sup>6</sup> DOWC supplies corporate services to both of these affiliates, therefore, common costs must be allocated with DOWC.

### **2.2. Methodology for Calculating Compensation**

The settlement states that the parties agree that AT Rule IV.B governs allocation of overhead expenses and that the proper allocation of staff and management time between DOWC and its affiliates should be reduced from the 154,800 minutes per year proposed in the application to 120,000 minutes per year. They also agree that allocations will be conducted according to AT Rule VIII.C.

### **2.3. Independent Audit Report**

The settlement states that the parties agree that the independent audit report submitted to DWA did not comply with the requirements of

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<sup>5</sup> UMS provides non-regulated and regulated contract billing and call center services for utility companies, service districts, municipalities, townships, cities, homeowner associations, condominium associations, golf courses, college housing and country clubs. UMS helps other water providers provide their customers with reliable water supplies to meet stringent federal and state water quality standards. UMS also conducts related non-regulated business, including sales of surplus, non-utility properties. (See Settlement Agreement, Attachment 1 at 2.)

<sup>6</sup> SAFOR is a property management company which owns and operates both residential and commercial property in California. SAFOR also conducts investment opportunities as a tenant in common with companies outside of the state of California. (See Settlement Agreement, Attachment 1 at 2.)

AT Rule VIII.E in Appendix A to D.10-10-019. They propose that DOWC's next audit due September 30, 2015, be supervised by DWA. According to Sections 3.12-3.19 of the settlement, supervision by DWA entails submitting bids by potential auditors to DWA, summarizing DOWC's criteria for evaluation/selection of potential auditors and obtaining final approval from DWA on the selected auditor. We agree in principle with the parties but revise the details of how the audit will be carried out.

In view of the fact that the first required audit under D.10-10-019 was not completed, we consider it prudent to modify the parties' settlement agreement to require that the independent audit due September 30, 2015, will not only be "supervised" by DWA, but carried out by DWA. D.10-10-019 implemented an audit specifically focused on affiliate transactions to ensure that the rules are properly followed. AT Rule VIII.E requires water utilities to have an audit performed biennially covering the last two calendar years which end on December 31. The audit is to be completed at shareholder expense. The audit due September 30, 2013, would have covered the period June 30, 2011, through December 31, 2012. This means that by September 30, 2015, four years will have elapsed without compliance. The goals of the rulemaking that led to D.10-10-019 – to provide consistent and understandable rules for all water and sewer utilities, to ensure the financial health of such utilities, prevent anti-competitive behavior in the competitive marketplace and ensure that affiliate transactions and non-tariffed products and services rules are applied uniformly to all similar

water and sewer utilities<sup>7</sup> - are thwarted if utilities do not comply with its mandates.

Having DWA carry out the audit itself, rather than “supervise” it, is inherently more expeditious than the tiered review described within the settlement. It is also appropriate to emphasize the significance that we place upon proper and timely compliance with D.10-10-019.

### **2.3.1 Selection of Auditor**

In carrying out the audit, DWA will engage an independent auditor from firms whose expertise and services have been approved for use on state projects. The audit costs will not exceed \$50,000. The scope of the DOWC audit will be limited to affiliate transactions requirements under D.10-10-019 for the period 2013-2014. The parties’ settlement agreement reflects the parties’ agreement and reasonable concern that the cost of DOWC’s independent audit should be appropriate for its size as a Class B water utility. DWA should ensure that the costs of the audit are appropriate given the limited scope of the audit and DOWC’s size. The cost of the audit report shall be paid by DOWC shareholders and the final report shall be made available to DOWC, and to the Directors of ORA and DWA.

### **2.4. Affiliate Transaction Compliance Plan**

The settlement reflects the parties’ agreement that the Affiliate Transaction Compliance Plan originally submitted with A.13-12-002 did not satisfy the requirements of AT Rule VIII.C in Appendix A to D.10-10-019.

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<sup>7</sup> D.10-10-019 at 2 (Summary), and 90 (Finding of Fact 1).

The parties attach a revised Affiliate Transaction Compliance Plan to the settlement agreement,<sup>8</sup> which satisfies the provisions of Resolution W-4954. The parties agree that the Continuing Service Agreements<sup>9</sup> between DOWC and its affiliates, UMS and Safor, should be amended to correctly implement the Affiliate Transaction Rules contained in D.10-10-019, and that the agreements should be reviewed as part of the next AT Rule VIII.E Independent Audit due September 30, 2015.

DWA has reviewed the revised plan and service agreements and we find that they comply with Resolution W-4954. These will be deemed submitted to the director of DWA upon Commission approval of the settlement agreement.

## **2.5. Safety Considerations**

The parties state that A.13-12-002 does not raise any safety considerations, because emergency procedures for DOWC are addressed in its GRC proceedings. We agree but note that compliance with Affiliate Transaction Rules will ensure that DOWC continues to remain financially viable, thus sustaining its important role in providing its customers with a reliable, safe and clean water supply.

## **3. Settlement Standard of Review**

In order for the Commission to consider a proposed settlement in this proceeding as being in the public interest, the Commission must be convinced that the parties had a sound and thorough understanding of the application and all of the underlying assumptions and data included in the record. This level of understanding of the application and development of an adequate record is

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<sup>8</sup> Settlement Agreement, Attachment 1.

<sup>9</sup> The Continuing Service Agreements are attached as Exhibits D and E to the application.



necessary to meet our requirements for considering any settlement. These requirements are set forth in Commission Rules of Practice and Procedure (Rules) Rule 12.1(a).<sup>10</sup> The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest. Rule 12.5 limits the future applicability of a settlement.<sup>11</sup>

In short, we must find whether the settlement satisfies Rule 12.1(d), which requires a settlement to be “reasonable in light of the whole record, consistent with law, and in the public interest.” As stated below, this settlement meets the three requirements.

### **3.1. The Settlement Meets the Standard of Review for Settlement**

The record consists of the filed application with attached documents, the proposed settlement and the motion for its adoption. The settlement resolves the concerns that ORA raised in its protest, addresses the issues within the scoping memorandum and provides sufficient information to permit the Commission to discharge its regulatory obligations.

ORA represents the interests of ratepayers. Accordingly, the settlement can be said to serve the public interest because resolving the protest is the result of negotiation by parties who have a thorough understanding of the issues and can make informed decisions in the settlement process. The settlement overall is

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<sup>10</sup> All subsequent Rules refer to the Commission’s Rules of Practice and Procedure. ([http://docs.cpuc.ca.gov/published/RULES\\_PRAC\\_PROC/70731.htm](http://docs.cpuc.ca.gov/published/RULES_PRAC_PROC/70731.htm))

<sup>11</sup> Rule 12.5 “Commission adoption of a settlement is binding on all parties to the proceeding in which the settlement is proposed. Unless the Commission expressly provides otherwise, such adoption does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.”

reasonable in light of the record and serves the public interest by resolving competing concerns in a collaborative and cooperative manner. By reaching agreement, the parties also avoid the costs of further litigation.

This said, as discussed in Section 2.3 above, we consider it prudent to modify the parties' settlement agreement to require DWA to carry out the independent audit due September 30, 2015, rather than merely "supervise" it.

### **3.2. Assessment of Penalties for Non-Compliance**

As previously stated, we consider proper and timely compliance with D.10-10-019, and the Affiliate Transactions Rules therein to be essential. The parties are to be commended for their ability to reach a reasonable settlement which addresses the requirements.

Strict compliance with the terms of the settlement is advisable, as doing so will avoid imposition of penalties. The Commission's power to levy fines and penalties, or to utilize other means it deems necessary to assure compliance with its orders and the law, is well established.<sup>12</sup> Sections 2107 and 2108 of the Public Utilities Code provide that:

Section 2107. "Any public utility that violates or fails to comply with any provision of the Constitution of this state or of this part, or that fails or neglects to comply with any part or provision of any order, decision, decree, rule, direction, demand, or requirement of the commission, in a case in which a penalty has not otherwise been provided, is subject to a penalty of not less than five hundred dollars (\$500), nor more than fifty thousand dollars (\$50,000) for each offense."

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<sup>12</sup> D.98-12-075.

Section 2108. "Every violation of the provisions of this part or of any part of any order, decision, decree, rule, direction, demand, or requirement of the commission, by any corporation or person is a separate and distinct offense, and in case of a continuing violation, each day's continuance thereof shall be a separate and distinct offense."

D.98-12-075 set forth five factors to be considered in assessing a penalty.

These are: 1) The severity of the offense and harm to ratepayers; 2) The conduct of the utility; 3) The financial resources of the utility; 4) The totality of the circumstances; and 5) The role of precedent. In this instance, DOWC undertook an independent audit as required by D.10-10-019, however, the audit did not appropriately address the entire scope of the issues under that Decision. DOWC communicated with Commission staff, received an extension of time to permit its auditors further review and again submitted a revised audit report that did not address the entire scope of the required issues. There was no harm to DOWC's ratepayers and DOWC's conduct suggests that it was making a good faith effort to comply. The totality of the circumstances suggests no intent to avoid compliance, rather an incomplete understanding of the requirements under D.10-10-019. Therefore, the Commission declines to impose any penalties on DOWC. However, to prevent imposition of penalties in the future, we direct DOWC to avoid future delays and to fully cooperate with DWA to ensure that the audit due September 30, 2015, is completed within a reasonable time.

#### **4. Categorization and Need for Hearing**

In Resolution ALJ 176-3327, dated December 5, 2013, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. This decision confirms the categorization and we affirm that a hearing is not necessary.

## **5. Comments on Proposed Decision**

The Proposed Decision of ALJ Miles in this matter was mailed to the parties on May 21, 2015 in accordance with Section 311 of the Public Utilities Code. Joint comments were filed on June 10, 2015 by the parties ORA and DOWC. The comments state concern about the potential cost of an audit carried out by DWA. The parties also request that DOWC be permitted to carry out the audit under DWA supervision as originally proposed in the settlement agreement. As stated in Sections 2.3 and 2.3.1 above, DWA will carry out the audit but will ensure that the cost of the audit is appropriate given the limited scope of the audit and DOWC's size.

## **6. Assignment of Proceeding**

Catherine J.K. Sandoval is the assigned Commissioner and Patricia B. Miles is the assigned ALJ in this proceeding.

## **Findings of Fact**

1. Resolution W-4954 required DOWC to file an application for review of the reasonableness of the general office, affiliate transactions and non-tariffed goods and services charged to DOWC ratepayers.
2. DOWC filed A.13-12-002 on December 1, 2013, and ORA filed a protest on January 3, 2014.
3. On November 20, 2014, DOWC and ORA filed a motion for approval of a settlement agreement which resolves the issues raised within the protest and includes an amended Affiliate Transaction Compliance Plan, as well as Continuing Services Agreements which comply with the requirements of D.10-10-019.

4. The record for approval of the settlement agreement is composed of the application, documents attached to the application, the settlement agreement and its attachments.

5. The parties to the settlement have a sound and thorough understanding of the issues and therefore make informed decisions in the settlement process.

6. The proposed settlement is reasonable in light of the record, consistent with the law and in the public interest.

7. Sections 3.12-3.19 of the settlement agreement require DOWC to engage an independent certified public accountant with utility client experience, to perform its audit due September 30, 2015, under the supervision of DWA.

8. It is reasonable to modify the settlement agreement to require that the independent audit due September 30, 2015 be carried out by DWA at DOWC's shareholder expense, and completed as soon as practicable.

9. DWA will engage an independent auditor from firms whose expertise and services have been approved for use on state projects.

10. The scope of the DOWC audit will be limited to affiliate transactions requirements under D.10-10-019 for the period 2013-2014.

### **Conclusions of Law**

1. The November 20, 2014 motion filed by DOWC and ORA to adopt their settlement agreement should be granted with modification of Sections 3.12-3.19 of the settlement agreement to reflect that the independent audit due September 30, 2015, will be carried out by DWA at DOWC's shareholder expense.

2. This proceeding should be closed.

**O R D E R****IT IS ORDERED** that:

1. The settlement agreement between Del Oro Water Company and Office of Ratepayer Advocates, filed on November 20, 2014 (Settlement), is approved with modifications to Sections 3.13-3.19 to reflect that the independent audit due September 30, 2015, will be carried out by Commission's Division of Water and Audits at Del Oro Water Company's shareholder expense. The Settlement is attached to this decision as Attachment A.

2. Del Oro Water Company's amended Affiliate Transaction Compliance Plan included as Attachment 1 to the November 20, 2014 settlement agreement between Del Oro Water Company and Office of Ratepayer Advocates, is deemed filed upon Commission approval of the Settlement.

3. The Commission's Division of Water and Audits will carry out the audit due September 30, 2015 as soon as is practicable, by engaging an independent auditor at Del Oro Water Company's shareholder expense.

4. Del Oro Water Company shall, at its expense, provide a copy of the independent audit report to the Director of the Office of Ratepayers Advocate and to the Director of the Division of Water and Audits.

5. The Application and attachments, and the Motion for Approval of the Settlement Agreement and attachments are admitted into the record.

6. Application 13-12-002 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.